CEE sovereign ratings: Our latest calls

The geopolitical situation has once again put the Central and Eastern European region at risk of sovereign rating downgrades. In May, Fitch downgraded the outlook for the Czech Republic, and we see an elevated probability of the same decision for Hungary. Indeed, we see downside risk across the region due to high energy dependence and geopolitics

Daily Life In Krakow, Poland - 15 Jul 2022

Source: Shutterstock

Emerging markets environment

The current environment of US monetary tightening, a stronger dollar, geopolitical risks and mounting growth concerns has renewed pressure on EM sovereign credit ratings, although the picture remains varied by country and region. Oil exporters in the Middle East, for example, are benefiting from high oil prices – Kuwait's outlook at S&P recently reverted to stable, from negative, Saudi Arabia currently has a positive outlook at both Fitch and S&P, while Oman was upgraded to BB- at S&P earlier in the year. Angola has similarly benefited from high oil prices, with its outlook at Fitch being moved to positive last week. In contrast, commodity importers have struggled – Turkey is a key example, having been downgraded to B by Fitch recently and facing negative outlooks at all three major agencies on the back of external pressures and unpredictable policymaking.

For sovereigns in Emerging Europe more broadly, key risks and sensitivities for ratings include political and trade relations with the EU, as well as exposure to Russian energy supplies. Croatia stands out as a bright spot for ratings in the region, receiving two-notch upgrades at Moody's and S&P after final approval to join the euro, but overall, the risks appear tilted towards downgrades rather than upgrades.

CEE: Our calls at a glance

Poland	Czech Republic	Hungary	Romania
Recent situation: Rating: A-/A-/A2 Outlook: Stable/Stable/Stable	**Recent situation:** Rating: AA-/AA-/Aa3 Outlook: Stable/Negative/Stable	**Recent situation:** Rating: BBB/BBB/Baa3 Outlook: Stable/Stable/Stable	**Recent situation:** Rating: BBB-/BBB-/Baa3 Outlook: Stable/Negative/Stable
Next review: 22 July (Fitch)	**Next review:** 5 August (Moody's)	**Next review:** 22 July (Fitch)	**Next review:** 7 October (Fitch)
Our call: No change over the next 12 months	**Our call:** No change, downgrade in case of gas supplies cut-off and a period of prolonged energy shortages	**Our call:** Elevated probability of a downgrade in rating outlook to negative	**Our call:** No change over the next 12 months

Note: Order of rating agencies - S&P/Fitch/Moody's

Source: S&P, Fitch, Moody's

Poland

Our call: No change over the next 12 months.

Rationale: In the CEE region, Poland is benefiting from significantly lower energy dependence and the diversification of energy supplies over the last few years. The fiscal metrics should not be a concern for rating agencies in the short term. We expect a deficit of 4.5% of GDP this year and 4.3% of GDP next year. The picture is neutral thanks to rapid nominal GDP growth. Debt-to-GDP will fall this year and next, and the big fiscal expansion in 2022 and possibly in 2023 should be offset by budget outperformance in 2021 and strong revenue growth this year.

Risks to our call: The more concerning issue for rating agencies may be growing macroeconomic imbalances, ie high inflation and the rapid rise in the current account deficit. As is the case across the region, we see limited downside risks to our call. The size of the fiscal expansion in 2022 and possibly in 2023 and credit easing (credit holidays) undermine the monetary tightening and thus the policy mix is not restrictive enough. This is the main risk that could make inflation more persistent. The current account balance deteriorated from a 3% of GDP surplus in 2020 to a deficit of 3.8% of GDP in May 2022. On top of that, the National Bank of Poland has signalled that it prefers a weaker zloty and FX intervention rather than further interest rate hikes. Meanwhile, fiscal tightening is unlikely in 2023. But still, with balanced risks to the current account, the economic slowdown in the second half of this year should calm domestic demand. In addition, a significant part of the high imports has been caused by the energy shock that other economies have also experienced. On the positive side, nearshoring provides upside risk to exports and GDP growth given that Central Europe is well positioned to take at least a percentage of the orders redirected from less reliable Asia partners.

CEE calendar

	Poland	Czech Republic	Hungary	Romania
Moody's	28 Oct	05 Aug	23 Sep	14 Oct
S&P	30 Sept	14 Oct	12 Aug	14 Oct
Fitch	22 Jul	21 Oct	22 Jul	07 Oct

Source: S&P, Fitch, Moody's

Czech Republic

Our call: No change, downgrade in case gas supplies are cut off and if there is a period of prolonged energy shortages.

Rationale: While Moody's and S&P affirmed the fourth highest rating (AA-/Aa3) in April, Fitch downgraded the outlook from stable to negative in May, the first downward change since 1999. Indeed, the Czech Republic is the closest to stagflation territory within the CEE region. Fiscal consolidation plans have vanished owing to the energy and geopolitical crisis, and it is one of the most vulnerable countries in the region in terms of energy dependence. On the other hand, based on the latest rating agency numbers, we see GDP forecasts more or less in line with our expectations, while fiscal policy metrics should be revised positively, in our view. Of course, the outlook of the rating agencies reflects the current Ministry of Finance projections, but we expect that, as every year, the state budget will end with a lower deficit than the government expects. Overall, we do not expect a rating downgrade this year and believe that the outlook will return to stable next year. Given that Fitch has proven to be the most aggressive agency since the Covid pandemic began, the October review will be key. By then, however, the new government's energy transition plan away from Russia and fiscal outlook should be clearer.

Risks to our call: Although we expect GDP growth to be just above 1% this year, we see a greater risk to our call on energy dependence and the associated impact on fiscal policy. In the event of an unexpected cut-off of gas supplies from Russia and a period of prolonged energy shortages, we can expect a downgrade from any of the rating agencies depending on the timing and scheduled rating reviews.

Hungary

Our call: Elevated probability of a downgrade in rating outlook to negative.

Rationale: The latest report by Fitch called Hungary one of the most vulnerable CEE countries due to its exposure to a gas cut-off. On top of that, the Rule of Law debate and the possible loss of EU funds looms large over the next rating reviews, especially as the EU hasn't clearly affirmed the positive voices telegraphed by Hungarian officials. We saw a turnaround in monetary and fiscal policy though, both being ultra-aggressive with tightening and breaking taboos (like changing the utility bill support scheme, raising tax on labour). The armada of decisions will improve the internal and external balances and will help the fight against inflation in the medium term, though this does bring Hungary one step closer to a recession. This mixed picture means the rating decisions might hinge on qualitative analyses and discretionary decisions. In this respect, we see the highest chance for a downgrade in the rating outlook to negative by Fitch, while S&P's latest positive reaction to the budgetary changes suggests there is a good chance of no change here.

Risks to our call: As it might be too early to quantify the impact of the recent changes on economic policies, rating agencies might decide to give more time to see the effects. A quick deal with the EU will save Hungary from rating/outlook cuts, while the escalation of the energy crisis poses a clear downside risk to the country's sovereign credit rating.

Romania

Our call: No change over the next 12 months.

Rationale: The long-awaited (and hardly begun) fiscal consolidation process will likely remain the most sensitive topic in rating reviews, given the still unclear path of fiscal reforms. However, being subject to the EU's Excessive Deficit Procedure and having already committed to fiscal reforms under the Recovery and Resilience Facility, Romania will have little choice but to apply the required measures in order to sustainably bring the deficit back to -3.0% of GDP. Moreover, partly due to the rapid growth as well, the general government debt/GDP seems to have stabilised close to 50%, which is broadly where the rating agencies seem to expect it as well.

Risks to our call: While on the budget deficit side we remain cautiously optimistic, we are reiterating our ever-stronger concerns regarding the deterioration in the balance of payments which – sooner or later – might become as important an issue as the budget deficit. The year-to-date developments show a staggering 80% widening of the current account deficit, to over EUR10bn, with less than 40% of the deficit being covered by foreign direct investment. Our initially pessimistic forecast for the current account deficit to reach 8.0% of GDP in 2022 looks more than on track now.

Author

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com